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Before the
**FEDERAL COMMUNICATIONS COMMISSION**
Washington, D.C. 20554

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| In the Matter of | ) | |
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| Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended | ) ) ) | |
| | ) | CC Docket No. 96-149 |
| and | ) | |
| | ) | |
| Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area | ) ) ) | DOCKET FILE COPY ORIGINAL |

# REPLY COMMENTS OF THE UNITED STATES DEPARTMENT OF JUSTICE

David Turetsky
Deputy Assistant Attorney General
Antitrust Division

Communications with respect to this document should be addressed to:

Donald J. Russell
Chief
Telecommunications Task Force

John Hayes
Economist
Economic Regulatory Section

Michael J. Hirrel
Scott Murray
Attorneys
Telecommunications Task Force

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SUMMARY

In this proceeding the Commission considers measures to implement the Telecommunications Act's safeguards when BOC affiliates are authorized to provide in-region, interLATA, services. Such measures are appropriate and will be helpful. The Commission should recognize, however, that regulatory measures cannot be as effective in preventing anticompetitive abuses as competition in local exchange markets.

The Commission's authority under Sections 271 and 272 of the Act extends to all interLATA telecommunications, whether interstate or intrastate. Such authority is expressly conveyed by the Act, and that conveyance supersedes the earlier jurisdictional principle stated in Section 2(b) of the 1934 Act. The Commission's interLATA authority includes telecommunications from one LATA to points outside the LATA, including international points. And where two BOCs merge, their successor "region" includes the two formerly separate regions.

With respect to structural separation and antidiscrimination, the Commission appears to support maximum separation and firm enforcement of the Communications Act's antidiscrimination measures. This approach is fully appropriate. Similarly appropriate is the Commission's emphasis on vigorous enforcement of the safeguards created by Sections 271 and 272 of the Act. The Commission should require the BOCs and their in-region long distance affiliates to file periodic reports concerning 1) costs arising from each other or from third party vendors related to the other, and 2) the quality, quantity and timing of services provided to each other. The burden of proof should be shifted in 90-day complaint proceedings to the defendant BOCs. And no presumption of reasonableness should attach in complaints concerning violations

of Section 271.

The Commission should not apply its dominant carrier regulations to BOC affiliates. The measures we suggest above, combined with continued dominant carrier regulation of BOC parents and the other measures the Commission proposes, are better tailored to address the market power arising from the BOC's control of bottleneck facilities. Application of the dominant carrier regulations to the affiliates may have unintended adverse consequences. Because the dominant carrier regulations should not be applied to the affiliates, the Commission need not engage in precise market definition here.

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# REPLY COMMENTS OF THE UNITED STATES DEPARTMENT OF JUSTICE

The United States Department of Justice ("Department") submits the following Reply Comments in the above captioned proceeding. In this proceeding, pursuant to Sections 271 and 272 of the Communications Act, the Commission is considering measures designed to restrict potential abuses of market power and unfair methods of competition by the Bell Operating Companies ("BOCs") in the long distance telecommunications market. The Department offers these Reply Comments to assist the Commission in its consideration of the competitive implications of this rulemaking.

## I. Introduction

The Commission's Notice of Proposed Rulemaking chiefly concerns measures designed to implement Section 272 of the Act, which is intended to protect the public, and to promote competition, during the transitional phase that will occur after the BOCs are permitted to provide in-region interLATA services. The BOCs may of course provide such services only after they have met the conditions laid out in Section 271 of the Act.

The Department urges the Commission to adopt a variety of measures, discussed below, that would facilitate the detection of some kinds of anticompetitive discrimination and cost misallocation by the BOCs, and that would enhance the Commission's ability to enforce the rules prohibiting such behavior. We believe, however, that the Commission should not require the BOCs' interLATA affiliates to comply with the regulatory measures typically associated with "dominant carrier" status.

We do not suggest that these measures could effectively eliminate anticompetitive behavior in an environment in which the BOCs' historic market power is undiminished. Regulatory restraints may alter, but they do not eliminate, opportunities for abuse of this market power, and they have little impact on incentives to abuse this power. The inherent difficulty of regulating anticompetitive abuse when the same firm controls local bottleneck facilities and participates in the downstream long distance market was an important reason why the integrated Bell Telephone System was broken up in the first place. U.S. v. AT&T, 552 F.Supp. 131 , 165-68 (D.D.C. 1982).

Indeed, the limited effectiveness of regulation was recognized by Congress, as reflected in the provisions of Section 271. Congress did not regard the regulatory protections specified in Section 272, standing alone, as sufficient protection against anticompetitive abuses of BOC market power. These regulations constitute only one of several requirements for BOC provision of in-region interLATA services. First, Congress required the Commission to implement and the BOCs to comply with the "competitive checklist" as a pre-condition to in-region long distance entry. In so doing, Congress unmistakably declared that local competition was needed, not only to bring benefits to consumers of local services, but also to protect competition in and consumers of interLATA services.

Second, Section 271(d)(3)(C) also conditions in-region long distance entry on a showing by the BOC that such entry is "consistent with the public interest, convenience, and necessity." Under well-established judicial and Commission precedent[1] this requirement demands that the Commission consider, among other things, whether entry would promote or harm competition.[2] This provision would have been unnecessary had Congress concluded that regulatory measures alone (including the regulation required by Sections 251 and 272) would constitute sufficient protection against anticompetitive conduct.

Third, in weighing applications under Section 271, the Commission is required to consult with the Department of Justice and to give "substantial weight" to its recommendations concerning 271 applications. This requirement reflects a Congressional decision that an analysis of competition must be an integral component of the Section 271 process. This requirement, too, indicates that Congress regarded regulation by the Commission as a necessary but not

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[1]See Bowman Transp., Inc. v. Arkansas-Best Freight System, Inc., 419 U.S. 281, 298 (1974), McLean Trucking Co. v. U.S., 321 U.S. 67, 86-88 (1944); U.S. v. F.C.C., 652 F. 2d 72, 81-82, 86-88 (D.C. Cir. 1980); Northern Natural Gas v. Fed. Power Comm., 399 F. 2d 953, 958 (D.C. Cir. 1968); In the Matter of Sprint Corp., 11 F.C.C.R. 1850 (1996); In Re Revision of Radio Rules and Policies, 9 F.C.C.R. 7183 (1994); MCI Comm., Inc./British Telecom., Plc., 9 F.C.C.R. 3960 (1994); In the Matter of MTS and WATS Market Structure, 81 F.C.C. 2d 177 (1980)

[2]Although we disagree with a number of the limits that the BOCs have suggested as constraints on the permissible scope of the Commission's public interest inquiry, counsel for one of the BOCs has written, "The standard public interest analysis considers the potential effect on competition." Wiley, Rein, & Fielding, Section 271 Guidebook, (July 1996).

sufficient condition for interLATA entry by the BOCs.

Moreover, while requiring a variety of regulatory measures to promote the development of competition in local exchange and access markets, Congress also envisioned the eventual deregulation of telecommunications markets. Congress did not intend for deregulation to permit the exercise of unchecked market power. Rather, it envisioned markets in which deregulation would serve consumer interests because market power had been replaced by competition.

The Commission is conducting this rulemaking prior to its review of any BOC applications under Section 271, and therefore it cannot be certain precisely what competitive conditions will prevail in local exchange and access markets at the time that in-region interLATA services are authorized. In light of the statutory framework, however, the Commission should regard the regulation required by Section 272 as a temporary supplemental measure which, in conjunction with competitive forces, will protect against anticompetitive behavior. The Commission should also recognize that these and other regulatory measures that might be necessary and procompetitive while the BOCs retain substantial market power would be unnecessary, and potentially anticompetitive, if that market power has been replaced by robust competition.

## II. Scope of the Commission's Authority over Intrastate InterLATA Telecommunications Services (Paragraphs 20 - 27)

The Commission may, as it tentatively concludes, exercise its authority under Sections 271 and 272 with respect to all interLATA telecommunications services, whether interstate or intrastate. The Telecommunications Act explicitly gives the Commission such authority.

Sections 271 and 272 grant the Commission authority over all "interLATA services," without qualification. Section 3 of the Act defines "interLATA service" as "telecommunications between a point located in a local access and transport area and a point located outside such area." 47 U.S.C. § 153(21). "Local Access and Transport Area," or "LATA," is defined as a contiguous geographic area established before [the date of enactment of the Telecommunications Act of 1996] by a Bell operating company such that no exchange area includes points within more than 1 metropolitan statistical area, consolidated metropolitan statistical area, or State, except as expressly permitted under the AT&T Consent Decree" or subsequently modified. 47 U.S.C 153(25).

The Act's definition of LATA expressly recognizes that a LATA may comprise an area, such as a metropolitan statistical area, smaller than a state. Thus when the Act defines interLATA services to include telecommunications from a LATA to a point outside the LATA, it expressly recognizes that interLATA services may include telecommunications between two LATAs within a single state. It necessarily follows that in granting authority over interLATA telecommunications services, the Act grants the Commission authority over telecommunications between LATAs within a state.

This conclusion is corroborated by the Act's express reliance upon the AT&T Consent Decree, where the LATA concept originated, and under which all LATAs were originally laid out. As part of the plan of reorganization of AT&T, the Consent Decree called for the division of all Bell territory in the United States into geographically-based "exchange" areas. U.S. v. Western Electric, 569 F.Supp. 990, 993 (D.D.C. 1983). The term "local access and transport area" was created as a replacement for "exchange area," shortly after the decree was entered to distinguish it from traditional telephone exchanges. Id. at 993-94, n.9. The Act's definition of "LATA" mirrors the definition of "exchange area" found in the decree. U.S. v. AT&T, 552 F.Supp. 131, 229 (D.D.C. 1982). Most LATAs laid out under the decree are based upon Standard Metropolitan Statistical Areas.[3] Thus, most LATAs comprise only parts of individual states, and most states have more than one LATA. Only nine LATAs out of a total of 158 encompass an entire state.[4] The Consent Decree governed interLATA telecommunications, whether inter or intrastate. The 1996 Act succeeds the decree, and in adopting the LATA system developed under the decree and in granting the Commission interLATA authority, the Act confers upon the FCC the same scope of authority as that contained in the decree.

The grant by Sections 271 and 272 of limited intrastate authority supersedes the jurisdictional principle stated in Section 2(b) of the original Communications Act. Section 2(b) was intended, when it was adopted in 1934, to govern other sections of the Act adopted at the same time. Congress in 1934 could not have anticipated the AT&T Consent Decree or Sections 271 and 272, which were adopted more than sixty years later. And when Congress adopted Sections 271 and 272, which explicitly rely on a LATA system with multiple LATAs within single states, it necessarily overrode to that extent the jurisdictional principle stated in Section 2(b). Nothing in the legislative history indicates that Congress intended Sections 271 and 272 to

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[3]"Simply put, [a Standard Metropolitan Statistical Area] is a U.S. Department of Commerce designation that includes a city and its suburbs. All SMSAs have a population of at least 50,000." U.S. v. Western Electric, 569 F.Supp. at 993, n. 8.

[4]States served by a BOC with only one LATA are: Delaware (the only State without a single autonomous LATA); Maine; New Hampshire; New Mexico; Rhode Island; South Dakota; Utah; Vermont; and Wyoming. The District of Columbia is covered entirely by one LATA, that also covers portions of southern Maryland and northern Virginia.

be limited by Section 2(b). On the contrary, as the Commission notes, Congress gave the Commission intrastate jurisdiction in other sections of the Act as well without discussing Section 2(b).[5]

Any interpretation here of Section 2(b) to alter Sections 271 and 272 would, as the Commission points out, lead to unexplainable gaps in the statute's coverage and other nonsensical results. Congress could not have intended, for example, to open up the intrastate interLATA market immediately for BOC entry, without the carefully-devised entry requirements of Section 271, while at the same time establishing those requirements with respect to interstate interLATA entry. Nor could Congress have meant to defeat the safeguards carefully imposed under Section 272 by permitting the BOCs to engage in the behavior which Section 272 prohibits, as long as they do it within the individual states. See NPRM, ¶ 25. When, as here, amendments to legislative enactments cannot be harmonized with earlier sections of the same acts, "the new provisions should prevail as the latest declaration of legislative will." 1A J. Sutherland, Statutes and Statutory Construction, § 22.34, p. 297 (5th ed. N. Singer 1993).[6]

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[5]NPRM, ¶ 26, n. 50. Sections 251 and 276, for example, grant the Commission jurisdiction for some purposes even over intraLATA telecommunications. If Section 2(b) applied to those sections, these grants of authority would be nullified.

[6] In American Airlines, Inc. v. Remis Industries, Inc., 494 F.2d 196 (2nd Cir. 1974) the court relied upon this principle in refusing to apply a provision of the Truth in Lending Act that exempted extensions of credit for business or commercial purposes, to an amendatory provision that made no such limiting distinction, even though Congress had not altered the limiting provision. The court stated "that by applying [the previously enacted provision] to limit the scope of . . . the credit card provision added in 1970, . . .we would produce such statutory obfuscation that it would surely thwart the intent of Congress." Id. at 200-201.

## III. International Telecommunications Authority (Paragraph 32)

The Commission tentatively concludes that Section 272 applies to both domestic and international interLATA telecommunications services. NPRM, ¶ 32. The Department agrees. As the Commission notes, the 1996 Act defines "interLATA services" as "telecommunications between a point located in a local access and transport area and a point located outside such area." 47 U.S.C. § 153(21). Any international telecommunications services provided by a BOC from its in-region states will fall within this definition. The definition does not distinguish between domestic and international services, and no such distinction is contained in Section 272. Under the AT&T Consent Decree, moreover, international services involving the U.S. were treated as covered by the interLATA prohibition, and there is no indication that Congress intended to change this approach.

## IV. Effect of Mergers on Extent of BOC Regions (Paragraph 40)

The Commission asks whether, if two BOCs merge, the "region" to which Section 272 applies is the combined two regions of the formerly separate BOCs. It is. As the Commission notes, Section 272(i)(1) defines "in-region state" by reference to the region in which a BOC was authorized to operate pursuant to the AT&T Consent Decree. Section 153(4)(B) defines a BOC to include its telephone exchange company successors or assigns. Thus, when any BOC is merged into or acquired by another company, the successor becomes the original BOC for purposes of the statute. When the successor company is a BOC, therefore, it both retains its original region from the Consent Decree and succeeds to the region of the acquired BOC. In effect, the successor BOC's "region" is now both its own original region and the region of the

BOC it acquired. This answer is not only required by the statute's definitions, but is also the only one that make sense for the statute's practical administration. Once two BOCs are merged, there are no practical means for it to have different affiliates in two regions each separate from the former, but no longer extant, original BOC.

The Commission also asks whether it should take any special steps to preclude discriminatory treatment by one BOC in favor of the other's long distance affiliate in the period between agreement upon and consummation of a merger. We agree that there is legitimate concern that a prospective merger might give rise to incentives to engage in anticompetitive conduct. A merger agreement, however, is only one of a wide variety of contractual relationships that might create such incentives.[7] We note that the antidiscrimination provisions of Sections 201, 202 and 271 already apply to a BOC's relationship with its prospective merger partner. Those sections govern the carrier's dealings with all long distance carriers alike, whether subsidiaries of prospective merger partners or not. The antidiscrimination provisions of Section 272, on the other hand, apply only to a BOC's potential discrimination in favor of its own affiliate. They do not apply to BOCs' relationships with affiliates of prospective merger partners. The Department believes that the Commission must strictly enforce Sections 201, 202 and 271 in a premerger situation, and in other contexts where incentives to behave anticompetitively might arise. Because each such situation is more or less unique, however, we

[7]See U.S. v. Western Electric Co., Inc., 12 F.3d 225 (D.C. Cir. 1993) ("Among the most important of [the purposes of the AT&T Decree] was to 'sharply limit the ability of businesses with bottleneck control of local telephone service to utilize their monopoly advantages to affect competition in competitive markets.' That objective would not be served if the reach of section II (D) were limited to BOCs and entities they own or control, as 'anything that can be accomplished by ownership of two [firms in vertical markets] also can be accomplished by a properly drawn contract' between them." at p.233)

believe that anticipatory rules may be less effective than continued case by case enforcement.

## V. Structural Separation and Antidiscrimination (Paragraphs 55 -89)

The Commission proposes numerous provisions to implement both Section 272's structural separation requirements and Sections 272 and 271's antidiscrimination requirements. The general direction of these interpretations appears to be that maximum separation should be required, and discrimination firmly prohibited. The Department agrees with this approach. The BOCs' affiliates might be permitted to enter the long distance business at a time when the BOCs still possess residual market power. As long as they do, they will have both incentive and ability to leverage that local exchange market power in ways that would harm competition and consumers. The Commission must strictly enforce the Act's structural separation and antidiscrimination provisions, in order to minimize such behavior.

Structural separation works best as a means to reduce the risk of cross subsidies to the same extent that maximum separation is achieved. Less than full separation reintroduces the very opportunities to misallocate costs that separation was intended to defeat. With respect to sharing of employees, for example, the Department agrees with the Commission that the sharing of administrative personnel, such as those in accounting, legal, and financial services, is both prohibited by the Act and contrary to the Act's objective to prevent cross-subsidization. Such sharing would make cost misallocation possible even in a regime of extensive record keeping by the BOC and vigilant auditing by the Commission. The Commission could not practically detect any but a minuscule percentage of the occasions on which BOC personnel devoted unrecorded time to affiliate problems.

With respect to discrimination, the Commission appears at several points to contemplate very specific rules to implement the Act's antidiscrimination provisions. Such rules, by supplying specific guidance, should assist in enforcement of the Act's provisions. But to preclude an unintended subversion of those provisions, the Commission should point out that its rules are prohibitory, not permissive. Discrimination that is prohibited by the Act is not permitted merely because it is not specifically mentioned in the rules. The Commission cannot realistically anticipate every form of improper discrimination by carriers with incentives to discriminate. Yet the adoption of specific rules might incorrectly be interpreted by some carriers as permitting what is not specifically prohibited.

The Commission tentatively concludes that a BOC may not transfer existing network capabilities to a separate competitive services affiliate. Such a transfer is prohibited, the Commission explains, by Section 272(a)'s requirement that all BOC "incumbent" local exchange carriers, including affiliates, be separate from affiliates that provide the competitive services. The Department agrees that if a BOC transfers local exchange network functions, facilities or other capabilities to an affiliate, that affiliate becomes an incumbent local exchange carrier. It must meet the separation requirements laid out in Section 272.

No other approach can adequately serve the precautionary purposes of Section 272's structural separation requirements. If affiliates provide their own local exchange network facilities, for example, BOCs will have strong incentives to shift facilities maintenance, upgrades and expansion to the affiliates, while leaving their basic networks to suffer. The affiliates might then, if not subject to Section 272's requirements, seek to deny essential network access to local and long distance competitors. Competitors would be left with the inferior surviving parts of the network. Mixing local exchange with long distance functions would also open opportunities for BOCs unfairly to tie provision of their monopoly local services to customers' purchases of their long distance services.

### VI. Enforcement of Sections 271 and 272 (Paragraphs 94 - 105)

The Commission asks whether it should impose reporting requirements designed to assist in enforcement of Sections 271 and 272. We believe that it should. We suggest that both parent BOCs and their in-region long distance affiliates be required to file periodic, publicly available, reports on two subjects. The first reports would concern all costs incurred by either a parent or an affiliate in transactions with the other, and costs arising from transactions with third parties dealing with both of them. Thus, all prices charged by the BOC to its affiliate, by the affiliate to the BOC, or by third party vendors to either the parent or the affiliate, if the vendor has a relationship with both, will be reported. This information will substantially assist in the detection of cost misallocations between BOCs and their affiliates.

The second reports would concern the quantity, quality and timing of each service provided by the parent to the affiliate, or by the affiliate to the parent. A BOC would, for example, be required to report each request for service by its affiliate, the number of circuits requested and provided, the length of time between the request and its fulfillment, and the circuits' technical specifications. To the degree that services can be objectively defined and measured, this information should assist in the detection of improper discrimination by a BOC in favor of its affiliate. We also encourage the Commission to consider other reporting requirements that could assist in the detection of discrimination that might be more subtle, even though it is more competitively significant. However, we recognize the inherent difficulty of identifying and preventing such discrimination through regulatory measures.

We believe that the risks to competition associated with cost misallocation and discrimination are sufficiently great to warrant imposition of these reporting requirements. Moreover, as we discuss below, we propose these requirements in lieu of dominant carrier regulation that might be imposed on the affiliates. We believe that these requirements would be both more effective in preventing anticompetitive behavior, and less costly, than that alternative.

The Commission asks whether it may award damages under Section 209 of the Act, in addition to the remedies specified in Section 271(d)(6)(A), for violations of Section 271, and whether it should in a 90-day complaint proceeding pursuant to Section 271(d)(6)(B) shift the burden of proof to the BOC once a complainant makes out a prima facie case. The answer to both questions, we believe, is yes. Nothing in Section 271(d)(6)(A) indicates that it provides the exclusive remedies for Section 271 violations. Thus, Sections 206 - 209, if their terms are met, continue to be available as statutory remedies for violations of Section 271.

The burden of proof should be shifted in 90-day proceedings, if complainants make out prima facie cases, simply because complaints would otherwise be impossible to resolve within the 90-day windows. Resolution of these cases will depend principally upon information exclusively within the control of the defendant BOCs. If complainants had the burden of proof, the cases could not be resolved until the complainants had been allowed extensive discovery. But such discovery cannot be conducted within a 90-day window for the whole proceeding. Shifting the burden to the BOCs will solve this problem by requiring them to take the initiative. If they have exculpatory evidence, they will quickly produce it. If they fail to produce such evidence, the Commission may reasonably conclude that the complaints are valid.

The BOCs argue in their comments that a burden shifting rule will impose on them the unpleasant task of responding to complaints that turn out to be unmeritorious. To the extent the BOCs are concerned about any complaint which fails to state even a facially acceptable claim, their concern can be addressed with measures aimed directly at the complainant. But a fear of frivolous filings cannot alone justify retaining the present burden allocation when, in a 90-day decision cycle, that allocation will effectively render the complaint process meaningless. And to the extent the BOCs are concerned that facially valid complaints will turn out, upon investigation, to be incorrect, the problem is an unavoidable consequence of the fact that the BOCs themselves have virtually all the information necessary to determine a complaint's correctness. If complainants were required to produce sufficient evidence of their own to prove their complaints, the complaint process would effectively be vitiated.

Shifting the burden of proof is unlikely, moreover, appreciably to increase the work the BOCs must perform now to respond to legitimate discovery requests. They will have to gather essentially the same information and present that information in a slightly different format. If the BOCs are confronted with a number of similar complaints, they will, we assume, develop a standard form of reply. The BOCs' responsibilities here should also be alleviated by measures which the Commission proposes to take--and should take--in CC Docket 96-150. BOC competitive services affiliates will be required to keep current books, in auditable form, according to generally accepted accounting procedures. When the affiliates maintain such books, they should be readily able to respond to complaints concerning cost misallocation and discrimination.[8]

The Commission also tentatively concludes that it should not employ a presumption of reasonableness in proceedings concerning violations of Section 271, even if it determines that BOC affiliates are not dominant. The Department agrees with this conclusion. Once a BOC is granted authority to enter long distance, its incentives to comply with Section 271, and particularly the checklist requirements of Section 271(c)(2)(B), will greatly diminish, as the Commission has recognized.[9] The Commission must therefore continue rigorously to enforce those requirements. Any presumption of reasonableness would almost certainly engender among the BOCs a sense of security that, absent truly egregious conduct, they may obstruct the development of local exchange competition with impunity. The Commission must not impart any such sense of security. It should in fact forcefully declare that it will not hesitate to suspend or revoke interLATA authority when it finds serious misconduct.

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[8] BellSouth is mistaken when it asserts in its comments that burden shifting here is barred by Section 7 of the Administrative Procedure Act. 5 U.S.C. § 556(d). That section imposes "formal" adjudicatory procedures, including allocation of the burden of proof to proponents, only on "hearings required by [the APA's] section 4 or 5." Section 4 is irrelevant here and Section 5 applies, by its own terms, only in "case[s] of adjudication required by statute to be determined on the record after opportunity for an agency hearing." 5 U.S.C §554(a). The phrase "to be determined on the record" is a term of art. Formal adjudicatory procedures are not required, the courts have repeatedly held, unless a statute specifically requires hearings to be determined on the record. A general requirement of hearings does not have the same effect. U.S. v. Florida East Coast Railway Co., 410 U.S. 224, 234 (1973); U.S. v. Allegheny-Ludlum Steel Corp., 406 U.S. 742, 757 (1972). Here, Section 271(6)(A) authorizes the Commission to impose penalties "after notice and opportunity for a hearing." It does not require this hearing to be "on the record." The APA's formal adjudicatory procedures, including allocation of burden to proponents, therefore are not required.

[9] Implementation of the Local Competition Provision in the Telecommunications Act of 1996, First Report and Order, CC Docket No. 96-98, FCC 96-325 (rel. August 8, 1996), ¶ 55.

## VII. Regulation of BOC Affiliates as Dominant or Non-dominant Carriers (Paragraphs 15 -18, 108 - 162)

The Commission asks whether BOC affiliates should be treated under the Commission's rules as dominant carriers in long distance markets. As we have indicated above, so long as the BOCs retain market power in local exchange and access markets, that market power will entail serious risks of anticompetitive behavior. The regulatory requirements that the Commission has traditionally applied to dominant carriers, however, were not originally designed for preventing the types of anticompetitive behavior at issue here. They are less well suited for that purpose than some alternative measures, as suggested above. For this reason, the Commission should not adopt such regulation for the BOCs' interLATA affiliates.

In the NPRM, the Commission correctly distinguishes between two types of market power: the power of an affiliate to raise price in the interLATA market by reducing its own output of interLATA services, and the power of the affiliate's parent (the BOC) to harm competition by using its market power in upstream markets for local exchange and access services. We address these two types of market power separately, below.

### A. Raising Prices By Restricting Output

The Commission's regulation of dominant carriers was originally designed to constrain a particular type of exercise of market power: The actions of a dominant firm to raise its prices by restricting its own output. Price regulation associated with dominant carrier status directly addresses that problem, by limiting the ability of dominant carriers to raise their prices above the levels established through this regulation.

The NPRM correctly observes that the BOC affiliates will begin providing in-region interLATA services with a zero market share, and seeks comment on whether an affiliate could quickly increase its share to the point where it could raise prices by restricting its output. In the Department's view, the Comments in this proceeding do not establish a likelihood that this would occur in the short term, and the Commission need not adopt regulation at this time to prevent the exercise of this type of market power. If in the future the affiliate's market share threatens to rise to the point at which it could profitably raise prices by restricting its output, either as a result of anticompetitive behavior or for other reasons, the Commission can adopt adequate measures to deal with the problem at that time.

### 1. Market Definition

We reach this conclusion, and we believe the Commission properly can reach the same conclusion, without undertaking a precise definition of the relevant market(s) involved in the provision of the affiliate's interLATA services. In requesting comment on how to define the relevant product and geographic markets in this proceeding, NPRM, ¶ 115, the Commission explains that it seeks to define markets in order to determine whether BOC in-region long distance affiliates will have market power. If they do, they would be classified as dominant under the Commission's rules. NPRM, ¶114. But as we explain below, any attempt to define precise relevant markets in this context is likely to be difficult and ultimately pointless, since there is no basis in the record for concluding that in the near future, the BOC affiliate is likely to have the ability to raise prices by restricting its output, regardless of how the Commission might define the relevant market(s) for interLATA services.

In the absence of a present need to define markets, the Commission should refrain at this time from doing so. Telecommunications markets are now in a transitional period. Postponing market definition determinations until there is a present need will allow the Commission to base its determinations on the most current information. A specific proceeding in which market definitions are necessary will also permit the Commission to focus on a more specific and definite universe of relevant facts.[10]

The Commission notes that market definition proceeds, in the first instance, from an analysis of consumer demand substitution factors, i.e, from asking which products or services, and which providers of those products or services, are regarded by consumers as reasonable substitutes for one another. From this perspective, the Commission points out that the various interstate, interexchange services may not be product substitutes for one another. NPRM, ¶ 118. Moreover, consumers do not regard interexchange calls originating in different locations to be

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[10]If the Commission chooses to define markets in this proceeding, it should, we believe, keep in mind the different objectives of regulation and antitrust enforcement, and how those differences may affect the application of market definition principles in those contexts. The manner in which the Commission applies market definition principles may differ in both methodology and purpose from how those principles are applied under the antitrust laws. The Commission's market definition, like market definition under the antitrust laws, should be guided by the basic economic principles that inform competitive analyses and market definitions under the DOJ Merger Guidelines. The Commission's objective, however, is to devise rules of general applicability. Such rules must apply to a large number of markets and market participants, must be established prospectively, and must remain reasonably stable over time. Moreover, the Commission must act on the basis of the limited information that is voluntarily supplied by parties in the rulemaking context.

By contrast, in merger cases brought under Section 7 of the Clayton Act, the objective is to delineate specific, individual markets, for the purpose of determining whether a particular acquisition may tend substantially to lessen competition "in <u>any</u> line of commerce in <u>any</u> section of the country . . ." 15 U.S.C. § 18 (emphasis added). In antitrust cases, market definition is based on intensive examination of the specific conditions associated with a specific transaction, using the full range of discovery powers provided under the Hart-Scott-Rodino Act, the Antitrust Civil Process Act, and the Federal Rules of Civil Procedure. Finally, in Clayton Act cases, the decision maker must decide whether a particular transaction is lawful or unlawful, rather than promulgate prospective, practically administrable rules of general applicability.

substitutes for one another. Thus, the relevant market could "be defined as all calls from one particular location to another particular location." NPRM, ¶ 123.

The Commission properly recognizes, however, that for its regulatory purposes examining markets at this level of detail would be impractical. NPRM, ¶¶ 118, 124. It would be a task of enormous complexity. The separate markets could number in the millions. For the Commission's purposes, moreover, all this effort would ultimately be pointless. For purposes of deciding whether and how to regulate interexchange carriers, as the Commission notes, "economic factors and the realities of the marketplace should cause point-to-point markets to behave in a sufficiently similar manner to allow [the Commission] to evaluate broader, more manageable groups of markets." NPRM, ¶ 124.

These practical considerations may differ from considerations that may be present in particular antitrust cases. Because of these differences, markets defined by the Commission may properly differ from markets defined under the antitrust laws. We urge the Commission explicitly to recognize this fact. The Department's Reply Comments in this proceeding are offered to assist the Commission in its consideration of market definition issues, and do not necessarily reflect the analysis or conclusions that the Department might adopt in reviewing any specific transaction under the antitrust laws.

In exercising its regulatory responsibilities, moreover, the Commission may need to define markets more precisely in future proceedings. In its Interexchange NPRM, the Commission proposed to define all interstate interexchange services as a single product market, and to define that market as a national market. NPRM, ¶¶ 118, 124; Policy and Rules Concerning the Interstate, Interexchange Marketplace, CC Docket No 96-61, FCC 96-123 (rel.

March 25, 1996), ¶¶ 47, 51-52. In doing so, however, the Commission recognized that a more refined market definition would be appropriate if there are competitively significant variations within this market. Id. Narrower product markets, for example, would be appropriate if "there is or could be a lack of competitive performance" within the narrower markets. NPRM, ¶ 118; Interexchange NPRM, ¶ 47. This approach is not unreasonable, in our view, at least for now. Changes in the telecommunications industry are occurring today, however, that will likely require the Commission to define markets more precisely in the future. These changes are likely to create differences in the practical alternatives available to consumers from one service to another, and from one geographic area to another. These changes may also result in significant differences in the structure and performance of various product and geographic markets.

One such change will be the entry of BOCs or other firms into the interexchange market. Each of the BOCs has announced plans to provide interexchange services on a substantial scale within its region. With respect to out-of-region interexchange services, however, there are substantial differences among the BOCs' entry plans and strategies, and each individual BOC appears to target for entry some out-of-region markets but not others. Because of these differences, one might reasonably expect, for example, that Ameritech would be a substantial competitor in the provision of interexchange services to consumers in Chicago, but not in Atlanta.

Similarly, if interexchange services increasingly will be offered as part of a bundled local/long distance product, differences among locations in the extent of local competition may lead to significant differences in availability of interexchange substitutes. Time Warner, for example, might become a significant competitor in the provision of interexchange service in markets that it enters as a CLEC, but not in other markets where it has no local presence. Analogous differences in competitive conditions are likely to develop with respect to various service offerings and customer groups, as well geographic areas. Competitive entry and expansion is likely to occur more quickly with regard to some services for some customer groups than for other services and other customer groups.

Because of these differences, the practical alternatives that are available to consumers, the touchstone of market definition, will differ from market to market. An interexchange carrier that does not offer service to a consumer in a particular location cannot be regarded as an effective substitute for those carriers who do; robust competition in one city or in the provision of one service will do nothing to protect consumers in another city or consumers who need a different service.

This does not mean that the Commission should attempt in this rulemaking to set out a precise delineation of relevant markets. The purpose of this rulemaking is to establish a regulatory regime for the separate affiliates required by Section 272. Attempting to establish different sets of regulations here for different markets within a single affiliate's region may be impractical. It would require the Commission, for example, to create and police an elaborate system of accounting separations for the different markets. Because the Commission must accommodate these practicalities, and questions of market definition aside, we believe that the Commission is not unreasonable in this proceeding to distinguish a BOC's provision of interexchange service outside its region from provision of such service within its region. Within a BOC's region, as the Commission points out and as we discuss below, there is a substantially greater risk of anticompetitive behavior.